NEW ENGLAND REALTY RESOURCES, LLC
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Capital Metes and Bounds

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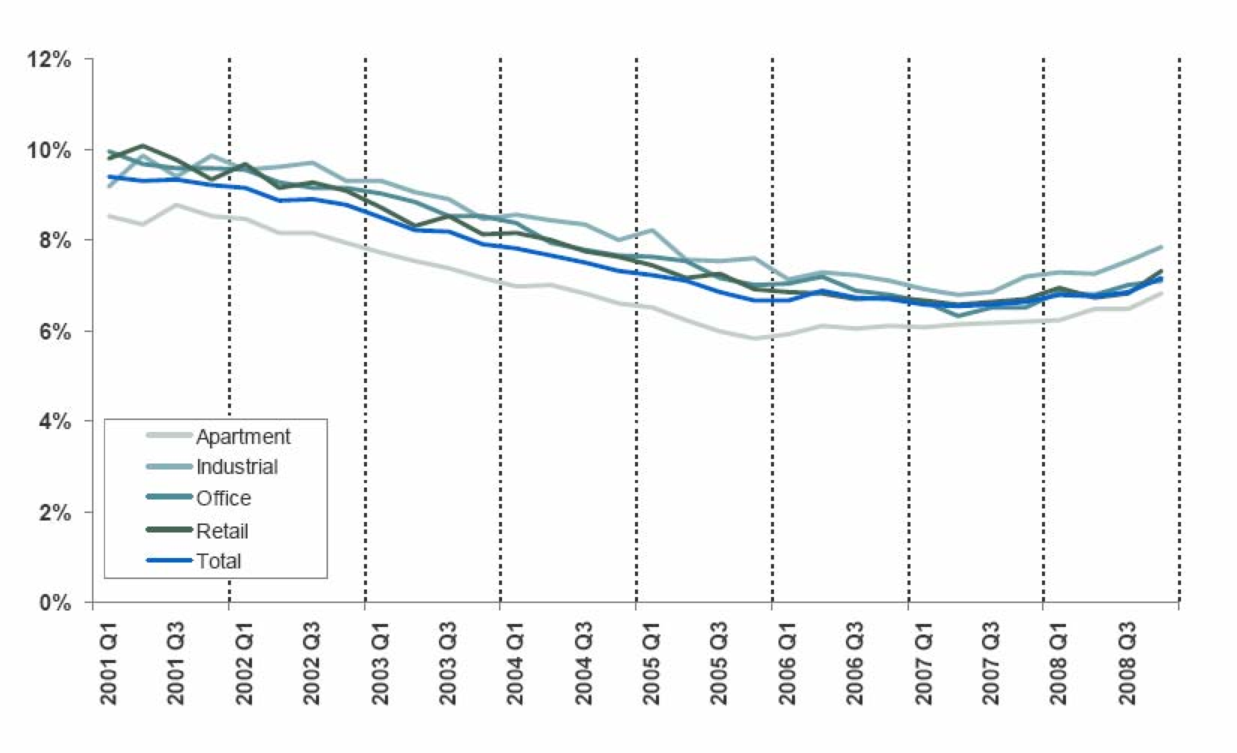
CAPITAL METES AND BOUNDS

"I am an optimist. It does not seem too much use being anything else."
-Winston Churchill

What if any good news is there that might be cause for optimism. There are several. The first and foremost is the reduction in the price of a barrel of oil from its peak of $147 per barrel to today's price of around $40. This in and of itself amount to a $250 billion saving for the American consumer. Second there is evidence that the corporate bond market is beginning to function again, albeit for the best credits. Since the beginning of the year over $78 billion of investment grade corporate bonds have been issued. Among those having success are Amgen, Proctor & Gamble, Caterpillar Financial Services, General Electric Capital, Cisco Systems, Altria Group, Verizon Wireless, AT&T and Conoco Phillips.

Just last week, the Mortgage Bankers Association of America held its annual Commercial Real Estate Finance (CREF) convention. While there was clearly cause for concern, most of the Life Insurance Companies and Banks in attendance are in the market for solidly underwritten mortgage loans on commercial real estate. Several were looking for new lending relationships in New England and Symetra, American Fidelity Assurance and Advantus chose Q10 New England Realty Resources as their correspondent. During the course of the conference, our correspondent companies expressed commitment to lend over $8 billion to commercial real estate in 2009. There is no question that underwriting has returned to historic norms. Interest rates are up and nothing long term will be committed with less than a 7% handle on it. Likewise loan to values will be not greater than 75% with most lenders looking to stay below 65% and willing to offer an interest rate discount for leverage less than 50% of value. Capitalization rates have also reverted to the mean and stand between 8% and 9% for most commercial real estate. Cash outs are a thing of the past. The charts below demonstrate the facts about the industry.

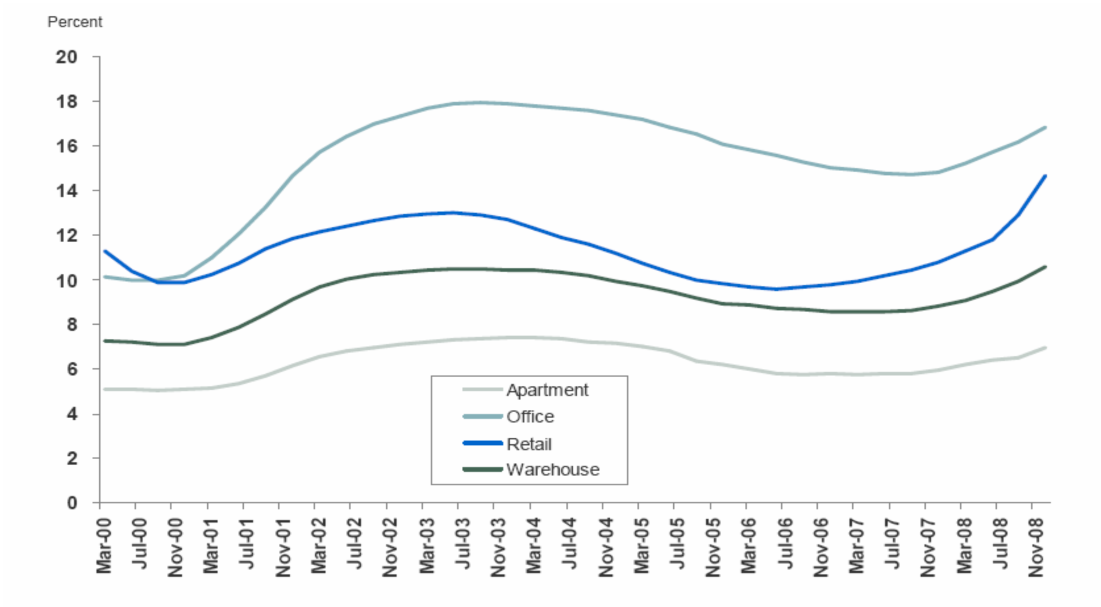
Capitalization Rates



Source: Real Capital Analytics

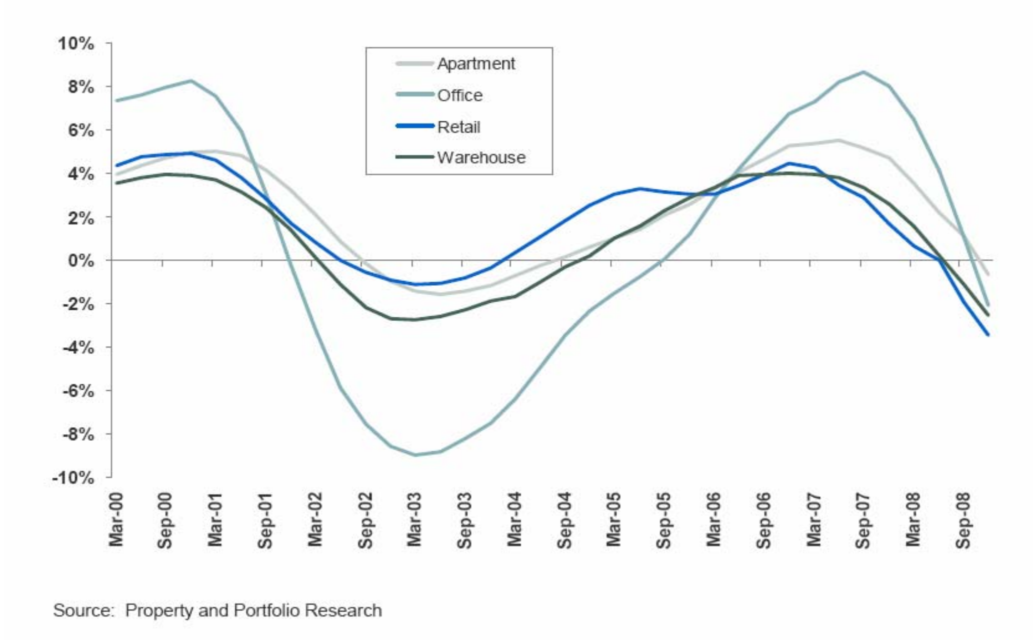
Vacancy levels are rising and rents are declining across all property types but apartments and warehouse are faring better.

Vacancies



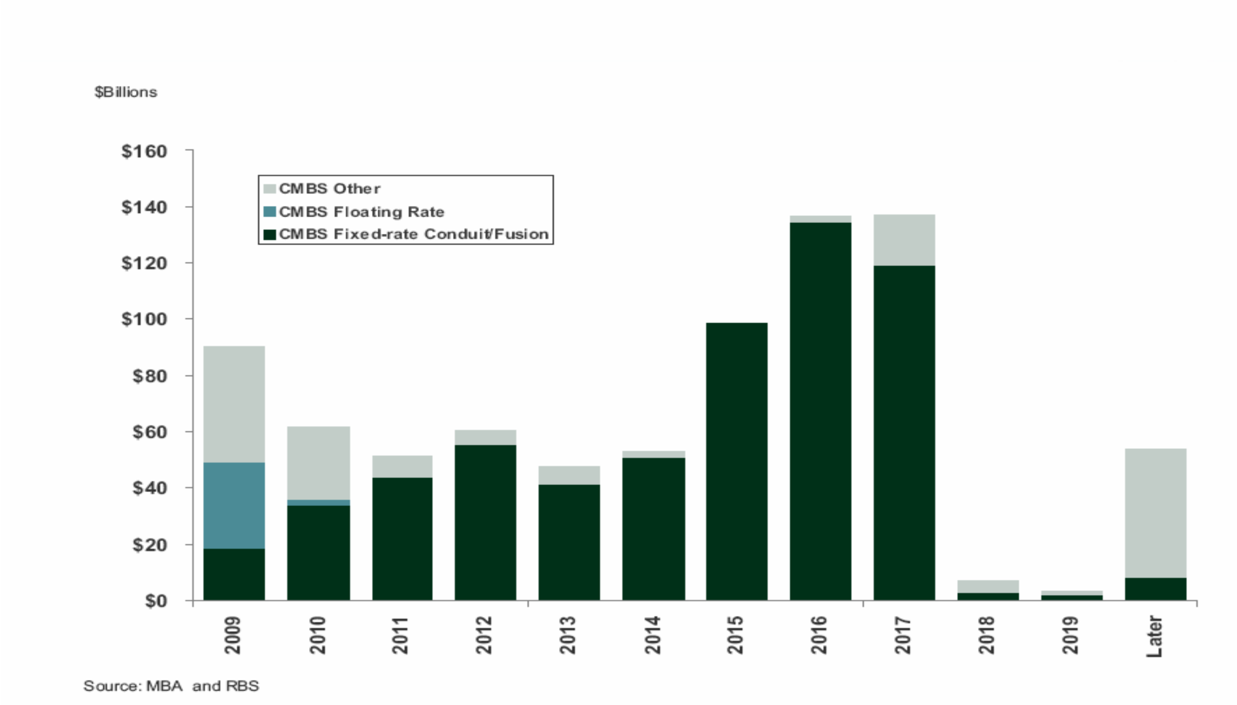
Source: Property and Portfolio Research

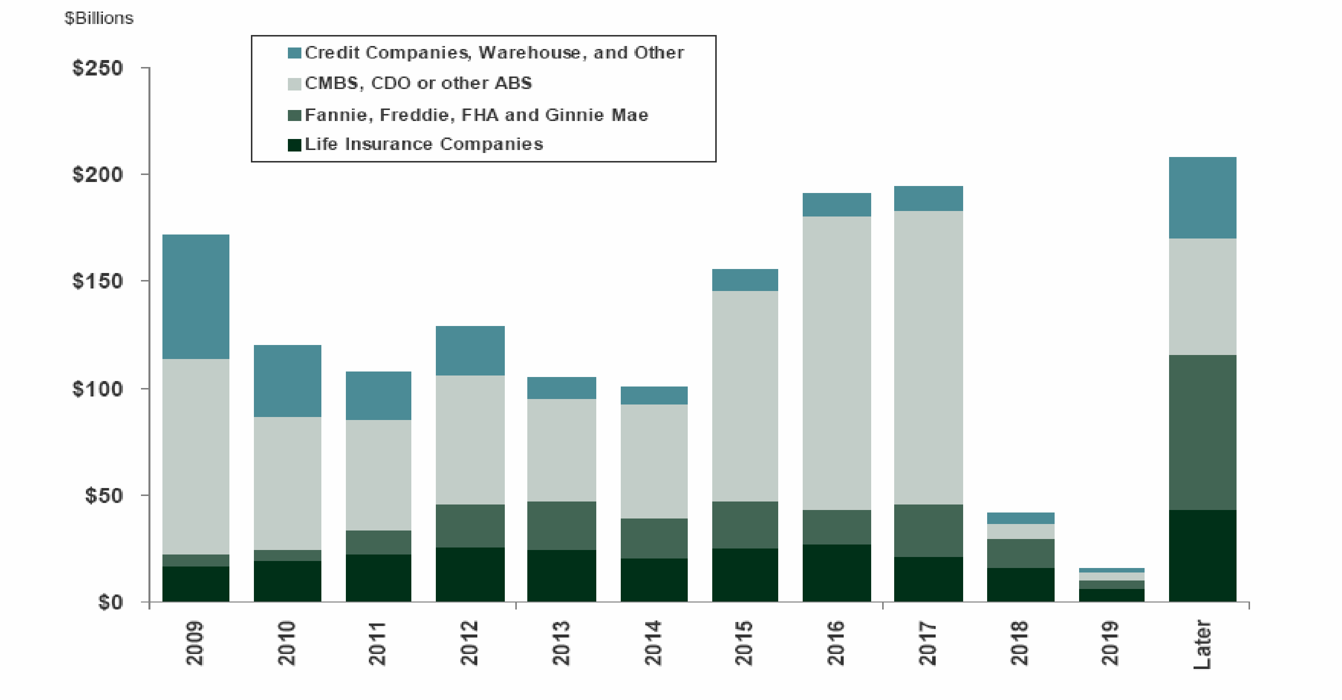
Rents as a year over %



Regardless of your beliefs about the level or direction of interest rates, the charts below when coupled with the current massive amount of government spending and borrowing should make you think about whether things are going to improve or worsen. The maturities of both securitized and portfolio debt in the next two years will make it difficult for lenders to meet their own roll over needs and even more so when you consider the competition of the federal government.

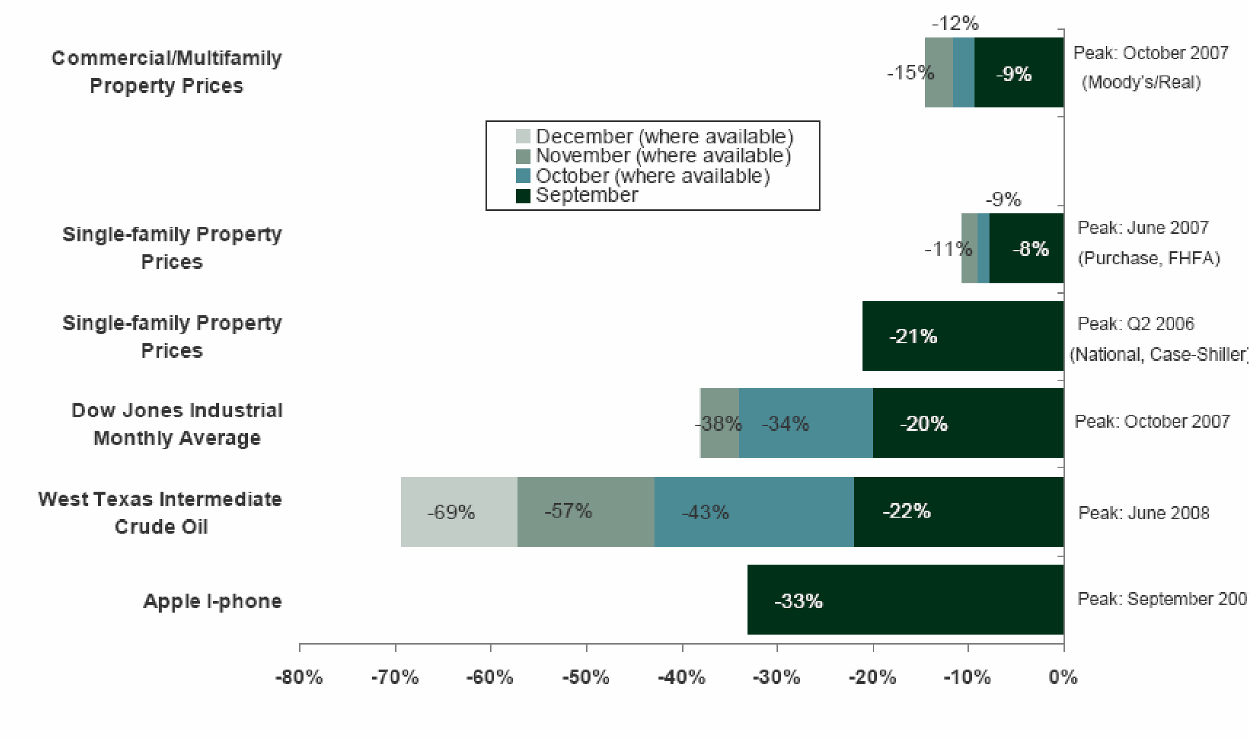
Maturities





Source: MBA

In spite of the above, commercial real estate as an asset class continues to perform well relative to other classes. As the chart below indicates, the decline in both commercial and residential real estate values compare well with other asset values.



Source: MBA, Moody's/Real, S&P, OFHEO, Wall Street Journal,.

In the past month, we have spoken with and visited many Life Companies. There has been a consistent theme that goes something like this: "How can my Chief Investment Officer justify lending on one off commercial mortgages when AAA CMBS tranches are yielding 1200 over the treasury curve?" In light of those comments, this anecdote might be helpful.

In one meeting, at the Commercial Real Estate Finance Conference sponsored by the Mortgage Bankers Association of America, a company that is currently out of the market has the real estate group is spending all of its time analyzing the current CMBS AAA holdings. One of the AAA tranches includes a Manhattan Office Building located on Park Avenue. The deal was part of a fusion issue done in 2006. The building income was capitalized at 3.5% and rents were projected to roll over at $120 per square foot while then current rents were $65.

Here is the rest of the story. Rents are in fact rolling at $65 per square foot. In the estimate of the seasoned real estate, professional analyzing the AAA tranche is an expected loss of 50% of the AAA investment. In light of this, the natural retort to the CIO question is to ask is whether the markets are rational in assessing such wide spreads or is there truly an unwarranted premium in AAA CMBS. Based on the anecdote, it appears to me that the answer is obvious. The real emperor has no clothes story is still being denied by the rating agencies. Why should anyone believe their analysis of CMBS ratings any more than their obviously flawed ratings of MBS? It is our belief that once stories like this play out, the availability of debt for commercial real estate will be negatively impacted . Call you Q10 New England Realty representative today!

Finally two quotes from Abraham Lincoln who our current President seems to want to emulate.

"You cannot lift the wage earner by pulling down the wage payer."
and
"You cannot establish security on borrowed money."